



COVID-19 and Intergovernmental Relations in Canada



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ABOUT THE AUTHOR

Dr. Enid Slack

Enid Slack is the Director of the Institute on Municipal Finance and Governance (IMFG) and an Adjunct Professor at the Munk School of Global Affairs and Public Policy at the University of Toronto. IMFG focuses exclusively on the fiscal health and governance challenges faced by large cities and city-regions in Canada and abroad. Enid has written extensively on metropolitan governance, intergovernmental fiscal relations, property taxes, municipal fiscal health, and financing municipal infrastructure. She has co-edited a number of books including *Financing Infrastructure: Who Should Pay?* and *Governance and Finance of Metropolitan Areas in Federal Systems*. Enid consults on municipal finance and governance issues with governments and international agencies such as the World Bank, IMF, UN Habitat, Asian Development Bank, the Inter-American Development Bank, the International Growth Centre, and the Forum of Federations. In 2012, she was awarded the Queen's Diamond Jubilee Medal for her work on cities.



1. FEDERAL AND PROVINCIAL ROLES

Canada is one of the most decentralized countries in the world so much of the response has been happening at the provincial level. Nevertheless, the federal government, which has the greatest capacity to raise revenues, has taken a lead role and is spending billions of dollars on financial supports for individuals and businesses who have been impacted by the crisis. Some of these programs include, for example, small business loans, temporary wage subsidies, availability of business credit, commercial rent assistance, benefits to workers who have lost their jobs, and tax deferrals. Furthermore, the Bank of Canada has the power to buy up to \$50 billion of provincial bonds over a 12-month period to help provincial governments borrow needed funds.

Provincial governments in Canada are responsible mainly for health care, education, public safety, social services, and long-term care. With respect to the pandemic, the power to issue stay at home orders is the responsibility of provincial governments. All Canadian provinces (and most municipalities) have invoked emergency powers. The federal government has the ability to invoke the Emergency Measures Act but has not done so to date. In terms of the lockdown and subsequent opening of the economy, each province has determined its own approach. The federal government has established guidelines, but the decision about when and how to open the economy remains with the provinces.

To limit the spread of the virus, provinces introduced several measures, including declaring a state of emergency, closing primary and secondary schools and daycare centres, shutting down restaurants (except for takeout), closing bars, restricting visits to long term care homes, closing gyms, restricting travel within and between provinces, and more. The measures imposed across provinces have been roughly similar, although the timing has varied from place to place. The next step will be to lift these restrictions, which will also be done by each province but will require cooperation among them to be effective.

2. LOCAL GOVERNMENT ACTIONS AND THE IMPACT ON MUNICIPAL FINANCES

Local governments are critical to the response to COVID-19 because they provide essential services to ensure the health and safety of individuals and they will be a significant player in the economic recovery that needs to follow this crisis. Local governments have enforced physical distancing measures, made changes to public transit such as imposing passenger limits, found additional spaces for the homeless population in part by re-purposing municipal facilities, and designed tax relief schemes for taxpayers (such as property tax deferrals as well as deferrals for payments for water, wastewater, etc.) who may be suffering income losses. Many have also declared a state of emergency to give them additional powers to take actions on public health and security.

COVID-19 has resulted in enormous fiscal pressures for local governments. Expenditures on public health, emergency services, and social services, for example, have increased in response to the crisis. At the same time, local governments have to do more cleaning of facilities, provide personal protective equipment (PPE) for staff, and address IT issues to



allow employees to work from home. There are some reductions in expenditures, however, because some municipal facilities such as libraries and recreation centres are closed, travel budgets have been cut, etc. These reductions offset, to some extent, some of the added expenditures.

The real hit to local governments, however, comes on the revenue side of the budget. Local governments receive the bulk of their revenue from property taxes (48 percent of revenues), user fees (22 percent), federal and provincial transfers (20 percent), and other revenues such as fines and permits, licensing fees, etc. (20 percent). Most intergovernmental transfers come from the provincial/territorial governments with only 3 to 4 percent coming from the federal government, largely for infrastructure.

Across the country, many local governments have allowed taxpayers to defer their property tax payments for 60 or 90 days without penalty or interest payments. Not only do they have to wait for the property tax revenues to come in but they also lose the revenues from penalties and interest payments. Local governments have also permitted the deferral of bills for water, wastewater, sewers, and waste collection and disposal. User fee revenues from transit have declined significantly especially in the larger cities as have revenues from parking, recreational programs, and other municipal services.

Local governments are limited in terms of how they can address revenue shortfalls. They are delving into their reserves, cutting some expenditures, largely by letting some staff go, and deferring capital projects. Local governments in Canada are permitted to borrow within the fiscal year while waiting for revenues to come in but the provincial government sets limits on how much they can borrow. Local governments are not permitted to budget for an operating deficit. They have not budgeted for deficits but they have ended with very large deficits resulting from the unexpected loss of revenues. When they run a deficit, they are required to pay it off immediately in the next budget year. Without any subsidies from other levels of government, shortfalls will have to be made up in the next year by increasing taxes or cutting services.

One province, Nova Scotia, introduced a new loan program that municipalities can apply for to help cover their revenue shortfalls arising from COVID-19. This program was developed in partnership with the Nova Scotia Federation of Municipalities and the Association of Municipal Administrators. Another province, British Columbia, passed legislation to permit municipalities in that province to extend their borrowing while awaiting revenues for a second year past the current limit of one year. Other provinces are considering passing similar legislation. Although this move could help local governments with immediate cash flow problems, local governments are not in a position to carry long-term debt. They have limited fiscal capacity and also deliver essential services that cannot be cut (e.g. water supply, roads, police and fire protection, etc.). More borrowing just passes the problem off to the future, potentially at a time when local governments face more pressure on the property tax – business closures will reduce the size of the property tax base and residential property taxpayers may still be unable to pay their property taxes. Local governments have been appealing to the federal and provincial governments for financial support to cover their operating deficits.



3. ROLE OF MAYORS AND MUNICIPAL ASSOCIATIONS

Mayors and councils have been invoking physical distancing, closing parks and other municipal facilities, and making decisions about how to balance their budgets in this crisis. Mayors are providing updates on local infection rates and major service disruptions, and encouraging residents to maintain physical distancing.

As a group, mayors and councilors have been lobbying the federal government through the Federation of Canadian Municipalities (FCM), a non-profit organization that advocates for municipalities to the federal government. Its members include more than 2,000 municipalities of all sizes and 20 provincial/territorial municipal associations. FCM has asked the federal government for \$10 billion in emergency operating funding to flow directly to municipalities to cover municipal operating deficits. In the past, the federal government has focused its funding to municipalities on infrastructure rather than operating expenditures. The government is currently considering this request as well as other ways to assist municipalities.

In addition to FCM, each province has at least one municipal association (some provinces have associations for rural and urban municipalities or French and English speaking municipalities, for example) that is looking to other orders of government for assistance. To date, provincial governments have not allocated special funds to municipalities to address for COVID-related pressures. To assist municipalities, however, some provinces have announced reductions or deferrals of provincial property taxes (usually for education). In many cases, they have also delayed the timing of payments by municipalities to the province for payroll deductions (such as workers' compensation) and for provincial property taxes collected by municipalities. As noted earlier, one province has changed legislation to allow municipalities to borrow more to meet operating needs; other provinces are considering similar measures.

4. PROVINCIAL-MUNICIPAL RELATIONS

A crisis of this nature tends to highlight some of the problems in the existing division of responsibilities between provinces and municipalities (for example, municipalities generally pay for some of the costs of public health and social services with property tax revenues). But, it also provides an opportunity to review the division of responsibilities and consider implementing some reforms.

In Canada, provincial governments are involved in every aspect of local service delivery through cost-sharing, policy setting, regulation, or other forms of entanglement. The complex relationship between provinces and municipalities needs to be reassessed on a regular basis to ensure that citizens receive the most effective, efficient, and highest level of services from their governments. A recent academic study on clarifying provincial-municipal responsibilities in one province (Ontario) recommends a principles-based approach to sorting out who does what -- what cities do best, what the province does best, where they can work together, and what resources cities are needed to fulfill



their responsibilities (https://on360.ca/wp-content/uploads/2020/01/In-It-Together-Clarifying-Provincial-Municipal-Responsibilities-in-Ontario_5FINAL.pdf).

The following principles are recommended to clarify provincial and local responsibilities:

1. **Take a collaborative approach:** rather than using a top-down approach, collaboration that engages municipalities, the business communities, and service providers would ensure greater buy-in.
2. **Follow the pay-for-say principle and avoid unfunded mandates:** A government's input into how a service functions should be matched with a corresponding responsibility to pay for that service. Unfunded mandates, whereby provincial regulations require local government to perform certain actions without providing money to meet those requirements, should be avoided.
3. **Consider local revenue capacity:** Any proposal to increase municipal service responsibilities should consider whether local governments have the necessary and appropriate resources to meet those responsibilities.
4. **Respect local and regional differences:** The costs of delivering services are not the same across each province. A review should take account of differences between regions. Asymmetrical arrangements may be required.
5. **Look forward, not backward:** A review of provincial-municipal responsibilities should look ahead to future challenges, such as how the aging population or climate events might affect local service costs.

The report also suggested that, in the case of Ontario, a review of who does what should begin with health and social services (which includes public health, ambulance services, long-term care, social housing, social assistance, and child care) because cost sharing is common for these services and the lines of accountability are less transparent.

5. FINAL THOUGHTS ON INTERGOVERNMENTAL FISCAL RELATIONS

The crisis created by COVID-19 has highlighted some of the cracks in our current fiscal arrangements. In particular, we are witnessing considerable pressure on provincial and local governments that do not have the necessary revenue sources to meet their mounting expenditure responsibilities. This problem is particularly acute for municipalities that rely mainly on property taxes and user fees.

On a positive note, the pandemic has resulted in unprecedented collaboration among all three orders of government, regardless of political affiliation. These governments have been meeting (virtually), coordinating their actions, and collaborating on most issues. The Prime Minister talks regularly with the provincial/territorial premiers about the crisis and the measures being taken to alleviate its worst effects on individual health and the economy. Moreover, a recent survey of mayors and municipal councilors showed overwhelming support for what their federal and provincial government counterparts are



doing in response to COVID-19 (<https://policyoptions.irpp.org/magazines/may-2020/municipal-leaders-happy-with-team-canada-response-to-covid/>).

The longstanding fiscal challenges laid bare by the pandemic, combined with the current level of intergovernmental cooperation and trust that has been built up over the last few months, provide a unique opportunity for governments to work together collaboratively to re-think intergovernmental fiscal relations in Canada – who does what and how to pay for it. It would be disappointing if the opportunity created by this crisis were wasted.

ABOUT THE FORUM OF FEDERATIONS

The Forum of Federations is a 'one-of-a-kind' international organization focused on federalism and decentralization – systems of governance which uniquely provides for the accommodation of diversity within a nation. Federalism provides a platform for all voices to be heard.

The Forum's mandate is a straight-forward and practical one, sharing the experiences, challenges and lessons learnt of its partners - federal countries and their sub-national units. The importance of this is significant as it offers peer exchange and understanding to reform efforts to improve the values, policies and polity each nation provides its citizens. Whilst it is true that there is no one-size-fits-all approach to federal design, there are commonalities within federations which offer opportunities to learn from one another."

The Forum is supported by the following partner countries – Australia, Brazil, Canada, Ethiopia, Germany, India, Mexico, Nigeria, Pakistan and Switzerland.

The Forum of Federations, the world's leading international network on federalism and decentralization, is concerned with promoting intergovernmental learning on governance challenges in multi-level democracies. Active on six continents, it runs programs in over 20 countries including established federations, as well as countries transitioning to devolved and decentralized governance options. The Forum is not an advocacy organization and doesn't advocate for any particular structure of government.



Forum of Federations
75 Albert Street, Suite 411
Ottawa, ON K1P 5E7
Canada
www.forumfed.org